

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

<b>In Re:</b>	)	
	)	
<b>INTEREX, INC.,</b>	)	<b>Case No. 00-10163</b>
	)	<b>Chapter 11</b>
<b>Debtor.</b>	)	
_____	)	
	)	
<b>INTEREX, INC., a/d/b XLR8</b>	)	
	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>Adversary No. 00-5295</b>
	)	
<b>VIRTEX,</b>	)	
	)	
<b>Defendant.</b>	)	
_____	)	

**MEMORANDUM AND ORDER**

This matter is before the Court on Plaintiff Interex's Complaint to Avoid Preference to Virtex (Doc.

1). The Court has reviewed the pleadings, stipulations and briefs in this case and is now prepared to rule.

**I. STATEMENT OF FACTS**

The parties have stipulated to the following facts:

1. Interex filed bankruptcy on January 24, 2000. Interex was in the business of manufacturing computer parts and operated from its principal place of business in Wichita, Kansas.
2. Virtex supplied component parts to Interex for use in its manufacturing process.
3. Interex and Virtex first began doing business in November, 1999, within ninety days of Interex filing for bankruptcy. The first shipment of component parts made by Virtex to Interex occurred November 10, 1999.

4. Virtex placed Interex on a “credit hold” on December 15, 1999, at which time Interex owed \$20,245.69. Placing Interex on a “credit hold” meant that no further inventory would be shipped by Virtex to Interex on credit terms without special arrangements between the parties. On or about December 15, 1999, Brad Heath with Virtex talked with Wes Inman and Brent Bahner, who both worked in Interex’s accounting department, about Interex’s credit situation with Virtex. The accounting department was in charge of paying accounts payable, maintaining cash flow and managing Interex’s inventory. In that conversation, Heath advised Inman and Bahner that no further shipments of inventory would be made by Virtex without payment by Interex of an amount that was past due at the time in the approximate amount of \$7,000.00. Inman and Bahner agreed to pay such amount so that shipments could continue.

5. Based on the agreement by Interex to make a payment on the past due invoices, additional inventory shipments totaling \$20,276.65 were made by Virtex to Interex between December 17, 1999 and December 29, 1999. An Interex check for \$6,499.94 dated December 22, 1999 was received by Virtex on January 3, 2000, and negotiated that same day. This check was for payment by Interex of Virtex invoice numbers 00002, 00003, 00004, 00005, V9900015 and a portion of V9900016, which were for shipments made November 10, 1999, November 13, 1999, November 15, 1999, November 29, 1999 and November 30, 1999, respectively.

6. Virtex again placed Interex on a “credit hold” on January 10, at which time Interex owed a total of \$34,022.40. On or about that date, Heath again talked with Inman and Bahner, advising them that no further shipments would be made without payment of additional past due invoices in the approximate amount of \$14,000.00. Interex agreed to remit such amount so that inventory shipments could continue. Based on that agreement, Virtex shipped additional component parts totaling \$14,070.00 on

January 11, 2000 . Interex check number 057918, dated January 20, 2000 for \$16,961.75 was received and negotiated by Virtex on January 20, 2000. This check was payment by Interex of Virtex invoice numbers 00006, 00007, V9900009, V9900011, V9900012, V9900013, V9900014, V9900017, V9900018, V9900026 and the remaining portion of V9900016, which were shipped on November 15, 1999, November 17, 1999, November 18, 1999, November 20, 1999, November 22, 1999, November 23, 1999, December 1, 1999, December 2, 1999, December 17, 1999 and November 30, 1999, respectively.

7. All Virtex invoices contained the following payment terms: “1.5%/10 days, Net 30,” which meant that a 1.5 percent discount would be applied for payments made within ten days of delivery, with no discount between the 11<sup>th</sup> and 30<sup>th</sup> day of delivery.

8. As of January 24, 2000, the date of filing, Interex still owed \$31,130.65 to Virtex.

9. Although not part of the stipulated facts, the Court also finds that Interex was insolvent when both payments were made to Virtex. Interex was presumed to have been insolvent when the payments were made because the payments were made during the 90 days immediately preceding the date of filing the petition. *See* 11 U.S.C. § 547(f).<sup>1</sup> Virtex has presented no evidence or argument to rebut this presumption.

Additional facts will be discussed below, when necessary.

## **II. ANALYSIS**

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<sup>1</sup>Unless otherwise noted, all future statutory references are to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq.

Interex, as a Chapter 11 debtor-in-possession, contends that the two payments of \$6,499.94 and \$16,961.75 made to Virtex constitute voidable preferential transfers pursuant to § 547(b). Interex can avoid these transfers to Virtex, subject to certain exceptions, upon showing that the transfers of its property were

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made —
  - (A) on or within 90 days before the date of the filing of the petition; or
  - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if —
  - (A) the case were a case under chapter 7 of this title;
  - (B) the transfer had not been made; and
  - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). The policy behind § 547(b) is to promote equality of distribution among the creditors by ensuring that all creditors of the same class receive the same *pro rata* share of the debtor's estate. *See In re Moses*, 256 B.R. 641, 647 (10<sup>th</sup> Cir. B.A.P. 2000).

Interex bears the burden of proving that all the elements of a preference are present under § 547(b). 11 U.S.C. § 547(g). Virtex impliedly stipulates to Interex's claim that the transfers in question

meet all the requirements of § 547(b) by never contesting them. Instead, Virtex contends the transfers cannot be avoided based on two exceptions to § 547(b) that are found in § 547(c), and one additional alleged exception based on the policy behind the Bankruptcy Code. Virtex argues first that the transfers were contemporaneous exchanges for new value given, second, that the payments were made in the ordinary course of business, and third, that Virtex did not receive an improvement in position by receipt of the funds. Once Interex has met its burden of establishing the existence of a preference, Virtex then bears the burden of proof that the transfers are not voidable under § 547(c). *See* 11 U.S.C. § 547(g); *In re Sunset Sales, Inc.*, 220 B.R. 1005, 1018 (10<sup>th</sup> Cir. B.A.P. 1998).

**A. Contemporaneous exchanges for new value under 11 U.S.C. § 547(c)(1)**

Virtex contends that Interex cannot avoid the transfers because they constituted a contemporaneous exchange for new value and are protected by 11 U.S.C. § 547(c)(1). In order to prevail under § 547(c)(1), Virtex must prove that the transfer was (1) intended by both Interex and Virtex to be a contemporaneous exchange for new value given to the Debtor, and (2), in fact a substantially contemporaneous exchange. The purpose of the contemporaneous exchange exception is to encourage creditors to continue to deal with troubled companies without fear that they will have to disgorge payments received for value given in the event a bankruptcy petition is filed. *See Collier on Bankruptcy*, § 547.04, at 547-49 (15<sup>th</sup> ed. rev. 2002).

Consistent with this purpose, § 547(c)(1) provides that a transfer is not a preference if the creditor provides new value in exchange for the debtor's contemporaneous transfer of property. *In re Dorholt, Inc.*, 224 F.3d 871, 873 (8<sup>th</sup> Cir. 2000). Other creditors are not adversely affected by such an exchange because the debtor's estate has received new value. *Id.*

According to Virtex, the payments made by Interex for the past due invoices constitute a contemporaneous exchange for new value because Virtex agreed to ship new products to Interex on credit if Interex paid its past due invoices. The Court disagrees. The payments by Interex do not fall within either the letter or the spirit of § 547(c)(1). Interex did not receive any additional property in exchange for the payments. The payments were used to pay prior debt and to make Virtex willing to sell new products to Interex on credit. The new products shipped by Virtex to Interex were in exchange for new debt created by the credit Virtex extended to Interex. Virtex may not have been willing to extend this new credit to Interex without the payments, but the payments on the past due invoices were not made in exchange for the new products.

This precise issue was addressed by the Ninth Circuit Court of Appeals in *In re Wadsworth Bldg. Components, Inc.*, 711 F.2d 122 (9<sup>th</sup> Cir. 1983). In *Wadsworth*, the debtor paid for goods by check in December 1979. After the check was dishonored because of insufficient funds, the creditor refused to fill additional Wadsworth orders until the check was paid. After being assured by Wadsworth that the check would be paid, the creditor shipped goods and materials to Wadsworth on credit a month later. The check was redeposited and honored by Wadsworth's bank on February 14, 1980. Wadsworth never paid for the goods delivered in January and filed bankruptcy in April 1980. In rejecting the application of § 547(c)(1), the court held, "Here, the stipulation of facts states that the debtor was required to pay *past* debts before it would receive further credit. Value was given only for a future promise to pay. The check, therefore, is not exempt from treatment as a preference by § [547](c)(1)." *Id.* at 124 (emphasis in original). *See also, Collier on Bankruptcy*, § 547.04[1][a], at 547-50 (stating "a vendor who conditions continued deliveries to the buyer on the buyer's payment of old invoices will not be protected by section 547(c)(1)

from attack by the buyer's trustee, even though the buyer's payment to the vendor and the vendor's transfer of property to the buyer occurred contemporaneously.'"); *Barnhill v. Johnson*, 503 U.S. 393, 400 (1992) (holding that a transfer is deemed to occur when check honored by drawee bank, not date of delivery).

The payments made by Interex for the past due invoices do not constitute a contemporaneous exchange for new value. In fact, the second payment exceeded the new shipments by nearly \$3,000, further demonstrating the transfers were not intended to be, nor were they, tied to specific new advances. See *In re Arrow Air, Inc.*, 940 F.2d 1463 (11<sup>th</sup> Cir. 1991) (stating that the creditor had the burden of proving that for each payment it received during the preference period, it extended a specific amount of additional credit to the debtor in a contemporaneous exchange). Therefore, Virtex's attempt to rely on § 547(c)(1) to prevent Interex from avoiding this transfer is rejected by the Court.

**B. Payments made in the ordinary course of business under 11 U.S.C. § 547(c)(2)**

Virtex next argues that the payments were made in the ordinary course of business and are, therefore, not voidable pursuant to § 547(c)(2). Under that subsection, the trustee may not avoid a transfer to the extent that such transfer was –

- (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
- (B) made in the ordinary course of business or financial affairs of the debtor and transferee; and
- (C) made according to ordinary business terms.

11 U.S.C. § 547(c)(2). Virtex, as the recipient of payments within the preference period, has the burden of proving, by a preponderance of the evidence, that the payments fall within § 547(c)(2). *In re Tulsa Litho Co.*, 229 B.R. 806, 809 (10<sup>th</sup> Cir. B.A.P. 1999).

Courts consider four primary factors to determine if payments are ordinary between the parties as required under the subjective test set forth in § 547(c)(2)(B): (1) the length of time the parties were engaged in the transaction at issue; (2) whether the amount or form of tender differed from past practices; (3) whether the debtor or creditor engaged in any unusual collection or payment activity; and (4) the circumstances under which the payment was made. *In re Sunset Sales, Inc.*, 220 B.R. at 1021-22 (10<sup>th</sup> Cir. B.A.P. 1998). These factors are typically considered by comparing pre-preference period transfers with preference period transfers. *Id.* at 1022.

In the absence of any pre-preference period transactions, which is the situation in this case, courts typically look to see if the debtor complied with the payment terms of its contract. *Id.* Late payments are typically not “ordinary,” unless the creditor establishes that a pattern of late payments was ordinary between the parties. *Id.* A defense under § 547(c)(2) should be narrowly construed. *Id.* at 1020.

Upon reviewing the four factors set out by the Tenth Circuit B.A.P. in *In re Sunset Sales, Inc.*, the Court finds that Virtex has failed to meet its burden to prove that the payments in question were ordinary payments between the parties, as required by § 547(c)(2)(B). Interex did not pay according to the terms the parties had agreed upon (that payments made within 10 days would receive a 1.5% discount with the balance due within 30 days). Virtex had to resort to placing Interex on a credit hold and refusing to ship any further products to Interex until the past due invoices were paid. Interex did not make payments on individual invoices, and on one occasion even split the payment of an invoice between two separate large



lump sum payments. The steps taken by Virtex to secure payment of the past due invoices, together with the circumstances surrounding the payments, show that these payments were not made according to the contract terms.

Virtex is also required to show that the payments were made under “ordinary business terms,” pursuant to § 547(c)(2)(C). In interpreting the objective test under this subsection, the Tenth Circuit has held that “ordinary business terms” are terms used in “‘normal financing relations’: the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy.” *Clark v. Balcor Real Estate Fin., Inc. (In re Meridith Hoffman Partners)*, 12 F.3d 1549, 1553 (10<sup>th</sup> Cir. 1993).

The Court finds that Virtex has failed to meet its burden to prove that the payments were made according to ordinary business terms. Virtex has provided no evidence to prove that this type of payment is ordinary in the industry, or even common when it deals with its other customers. The facts stipulated to by the parties essentially ignore this objective test. Interex’s payments to Virtex were only made because Virtex put Interex on a credit hold and refused to ship any further products. Interex in turn made large, lump sum payments to Virtex to pay off past due invoices so it could continue to purchase products. In absence of any evidence to the contrary, the Court finds that making large, lump sum payments on past due invoices under these circumstances is not “the kind of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy.”

Virtex has provided no evidence to establish what industry standards exist to which these transfers allegedly conform. Virtex has failed to prove that the payments made in this case were common within the industry and has, therefore, failed to meet its burden to prove that the payments were made according to ordinary business terms. *See In re Sunset Sales, Inc.*, 220 B.R. at 1021 (affirming bankruptcy court’s

finding that creditor had failed to meet its burden to prove application of § 547(c)(2) because creditor had failed to offer any evidence that the payments were made within the norms of the relevant industries involved in the case).

Because Virtex has failed to prove that the payments made by Interex occurred within the ordinary course of business, under both the subjective test required by § 547(c)(2)(B) and the objective test required by § 547(c)(2)(C), the Court finds that § 547(c)(2) does not save these payments from being voidable transfers.

### **C. Whether Virtex had any improvement in position**

The final argument made by Virtex in its brief, which argument was made without citation to authority, is that the transfers should not be avoided because its net financial position was not ultimately improved by the payments made by Interex. Virtex relies exclusively on a general statement that “[t]he policy of the Bankruptcy Code is to encourage creditors to not precipitate a debtor’s decline.” The Court agrees, in general, with that proposition and notes that is the policy behind § 547(c). Interex, however, notes that if Virtex, by this argument, is attempting to rely on § 547(c)(4), it has waived that argument by failing to cite to that subsection or to include the elements for that subsection in the Pretrial Order (Doc. No. 14).<sup>2</sup> This Court agrees, and finds that if Virtex is now attempting to rely on § 547(c)(4), it has waived its right to do so. If Virtex is not relying on § 547(c)(4) to make this argument, the Court finds that general

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<sup>2</sup>The Court notes that Virtex specifically cited to, and set forth the elements of, subsections 547(c)(1) and (2) in the Pretrial Order, while omitting the same information regarding a § 547(c)(4) defense. *See* § 7.2 of Pretrial Order.

policy considerations behind the Bankruptcy Code are not a sufficient basis to create additional exceptions to the voidability of preferential transfers.

#### **IV. CONCLUSION**

The Court finds that the Debtor's Complaint to Avoid Preference to Virtex should be granted. Virtex does not contest that the payments made by Interex meet the requirements of a preferential transfer under § 547(b). Virtex's reliance on § 547(c)(1) to excuse the preferential transfers is not valid because the transactions did not involve a contemporaneous exchange for new value. Similarly, Virtex's reliance on § 547(c)(2) is without merit because Virtex failed to prove that the payments made by Interex were made in the ordinary course of business and according to ordinary business terms. Finally, for the reasons noted above, the Court rejects Virtex's argument that the transfers should not be avoided because Virtex did not improve its position by virtue of its receipt of the transfers.

**IT IS, THEREFORE, BY THIS COURT ORDERED** that judgment on the Debtor's Complaint to Avoid Preference to Virtex (Doc. 1) shall be entered in favor of the Debtor.

**IT IS FURTHER ORDERED** that the transfer by the Debtor to Virtex in amount of \$6,499.94 on December 22, 1999 and the transfer in the amount of \$16,961.75 on January 20, 2000, are hereby avoided pursuant to 11 U.S.C. § 547(b).

**IT IS FURTHER ORDERED** that judgment is entered in favor of Interex and against Virtex in the amount of \$23,461.69, together with the Debtor's costs of this action.

This Memorandum shall constitute findings of fact and conclusions of law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A

judgment based on this ruling will be entered on a separate document as required by Rule 9021 of the Federal Rules of Bankruptcy Procedure and Rule 58 of the Federal Rules of Civil Procedure.

**IT IS SO ORDERED** this 16<sup>th</sup> day of April, 2003.

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Janice Miller Karlin  
United States Bankruptcy Judge

**CERTIFICATE OF SERVICE**

The undersigned certifies that copies of the attached Memorandum Decision and Order was deposited in the United States mail, postage prepaid on this \_\_\_\_\_ day of April, 2003, to the following:

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